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IMPROVING THE INTERNATIONAL TRADING SYSTEM

Summary

Although the General Agreement on Tariffs and Trade has enjoyed great success in reducing tariffs, it appears incapable of stemming the rising tide of protectionism. A declining share of world trade is handled by the GATT and that share is not handled very well. A new round of multilateral trade negotiations, which could begin in late 1986, is vital to improve the world trading system. And as in most previous rounds, participants should agree to forego additional barriers while the discussions are underway.

A key priority in trade talks will be the negotiation of a safeguards code that would bring the numerous voluntary restraint agreements under GATT discipline. GATT rules should also be extended to cover agricultural and service sector trade, which presently lie outside the GATT framework. Moreover, the industrialized countries should agree to phase out the Multi-Fiber Arrangement and bring developing countries into the mainstream of the GATT system.

World Trading System in Disarray

The General Agreement on Tariffs and Trade, established in 1948, was intended to reverse the mercantilist policies of the 1930s that helped produce the Great Depression. Negotiated as one of many agreements to be included in the proposed International Trade Organization, it became the trade agency by default after governments failed to ratify the ITO. Consequently, the GATT

does not have the authority in trade that the International Monetary Fund exercises over finance or the World Bank over development. But GATT negotiations, which have lowered the average tariff on manufactured goods among major countries from 40 percent in the immediate postwar period to 5 percent today, have encouraged the expansion in world exports from $61 billion in 1950 to almost $2 trillion in 1984 (see Table 1).

Global trade, however, is being choked by a growing accumulation of restrictive measures that ignore or evade GATT rules. In response to the second oil shock and the worldwide recession of 1981-82, governments have increasingly relied on managed trade to protect jobs. Major segments of world trade have been removed from GATT's jurisdiction and subjected to "voluntary" restraint agreements negotiated under importers' threats. Of the top ten products in world trade (see Table 2), four -- cars, steel, textiles and clothing -- are largely controlled by discriminatory bilateral agreements. Furthermore, the developing countries, which account for an increasing share of world production, are largely outside the GATT system.

Although GATT's 90 member countries account for 80 percent of world trade, only some 20 percent of total trade is conducted under GATT rules, according to one study. Another report by a U.S. presidential commission claims that GATT rules now apply to less than 5 percent of world trade compared to 20 percent in 1950. These trends explain the spreading frustration at the GATT's inability to stem the rising tide of protectionism and resolve trade disputes. A declaration adopted at the ministerial meeting of the GATT in November 1982 begins with the warning that "The multilateral trading system . . . is seriously endangered." Many observers believe that unless something is done, GATT will become increasingly irrelevant.

The United States, with the support of Japan, has pushed for a new round of multilateral trade negotiations to improve the international trading system. This would be the eighth round. The first six, ending with the Kennedy Round (1963-67), focused on reducing tariffs. Subsequently, nontariff measures, which include many legitimate domestic policies, became the major barriers to trade. The success of the postwar trading system in promoting the integration of the global economy has blurred the line between domestic economic policies and foreign trade policies. The Tokyo Round, which ended in 1979, attempted to address many nontariff measures. Five years of hard bargaining produced seven codes covering areas such as government procurement, domestic subsidies, standards and import licensing procedures.

Despite the agreement by the major industrialized countries at the 1984 London Economic Summit to begin a new round, there has been a decided lack of enthusiasm for trade talks. Some observers argue that governments should fully implement the Tokyo Round agreements before beginning new negotiations. A GATT economist estimates that world exports would be 40 percent higher if current agreements were followed to the letter. Other analysts see too great a risk of failure in negotiations that could harm an already weakened world trading system and lead to the unraveling of current agreements. They note that negotiations have a better chance of success during periods of rapid expansion, but

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Table 1: World Exports, 1950-1984

(in billions of dollars)

Year	Agricultural Products	Minerals*	Manufactures	Total
1950	$28	$9	$23	$61
1955	33	17	42	93
1960	40	21	64	129
1965	50	31	103	187
1970	64	51	190	312
1975	150	207	501	875
1980	299	567	1,095	1,989
1981	294	550	1,090	1,963
1982	271	493	1,053	1,844
1983	267	453	1,057	1,807
1984	280	454	1,148	1,915

*Including fuels and nonferrous metals.

Source: General Agreement on Tariffs and Trade, International Trade 1984/85, p. 201.

Table 2: Major Products in World Trade, 1973 and 1983

(shares of value of world trade)

	1973	1983
Crude Petroleum	7.6%	12.4%
Petroleum Products	2.4	4.9
Cars	3.8	3.8
Steel	4.6	2.8
Textiles	4.1	2.6
Clothing	2.2	2.2
Data Processing Equipment	1.4	2.2
Automotive Parts and Accessories	2.2	2.0
Natural and Manufactured Gas	0.3	2.0
Plastics	1.9	2.0

Source: The Economist, January 4, 1986, p. 55.

the growth of world trade has slowed from 9 percent in 1984 to 3 percent in 1985. Furthermore, the consensus on the merits of liberalized trade has weakened substantially. Some believe that preservation of a way of life is preferable to the efficiency gains of reduced trade barriers. Others claim that widespread government intervention in economic affairs has distorted markets and destroyed the rationale for liberalizing trade.

A number of observers who view exchange rate misalignment as the major cause of the trading system's problems believe that reform of the international monetary system is more important than a new round of trade negotiations. A private-sector trade policy advisory committee, for example, expressed concern to the U.S. trade representative in May 1985 that trade talks would divert attention from this issue.

At the beginning of the floating exchange rate system in 1973, it was thought that exchange rates would respond primarily to changes in the trade balance. But short-term capital flows, which are affected by factors other than trade, are estimated to have reached $40 trillion annually and have swamped the $2 trillion in annual trade flows. Furthermore, the volatility of exchange rates has increased as a result of floating exchange rates, liberalized capital markets and advances in telecommunications. The combination of misalignment and volatility significantly increases the cost of foreign trade and makes planning more difficult. For this reason, France has insisted on parallel talks to reform the international monetary system.

In addition, the debt crisis has forced many developing countries to restrict imports to meet their debt service payments (see Table 3). World Bank figures show Third World debt totaled $950 billion at the end of 1985 and will exceed $1 trillion this year. Developing debtor nations paid about $22 billion more to banks and other lenders last year than they received in new loans.

While these factors have contributed to the problems of international trade, it is important to continue to work at lowering trade barriers. The history of the trading system argues that momentum is crucial: the system either moves forward toward increased liberalization or topples under protectionist pressures. A new round of trade talks would help prevent the collapse of the current system, as well as promote growth. According to an Institute for International Economics report, growth in world trade resulted in a 0.25 percentage point annual increase in world output between 1953 and 1973. A Brookings Institution study estimated that the benefits of the Tokyo Round were 50 to 100 times greater than the adjustment costs for the major industrial countries.

Measures to Improve GATT's Framework

After many delays, GATT members finally agreed at the November 1985 annual meeting to establish a preparatory committee to plan an agenda for a new round. Work began in January and is expected to be completed by June. If the agenda is approved at the September 1986 ministerial meeting, the new round will officially begin. Approximately 30 topics have been proposed for negotiation, reflecting the diverse interests of the member countries. The agenda should not only include measures to improve the existing framework but also to expand GATT's coverage to new areas. Two of the most important items in the former category are a safeguards code and improvement of the dispute settlement procedure.

Table 3: Trade Performance of Major Debtor Countries

(in billions of dollars; average annual real growth rates, 1980-84)

Country	Debt Outstanding, 1985*	Gross Domestic Product	Exports	Imports
Argentina	$ 50.8	-1.6%	3.6%	-14.7%
Bolivia	4.0	-4.7	-1.7	-15.8
Brazil	107.3	0.1	10.8	-7.3
Chile	21.0	-1.4	0.7	-4.2
Columbia	11.3	1.8	0.8	2.4
Costa Rica	4.2	-0.4	1.1	-9.1
Ecuador	8.5	1.1	2.6	-13.7
Ivory Coast	8.0	-2.3	1.3	-8.8
Jamaica	3.4	1.3	-2.5	-2.1
Mexico	99.0	1.3	10.5	-14.5
Morocco	14.0	2.5	4.1	-1.0
Nigeria	19.3	-4.7	-13.3	-12.1
Peru	13.4	-0.7	-0.6	-10.8
Philippines	24.8	0.8	3.6	-4.8
Uruguay	3.6	-3.7	2.2	-11.3
Venezuela	33.6	-1.8	-3.8	-19.3
Yugoslavia	19.6	0.6	-0.6	-8.1
Total	445.9	-0.3	1.8	-9.2

*Estimated total external liabilities, including International Monetary Fund credits.

Source: Washington Post, March 27, 1986, p. E3.

Safeguards Code - The rapid shift of comparative advantage among countries and the excess capacity that exists in many industries has led to increased pressure to restrict imports. Article XIX of the GATT allows temporary "safeguards" to protect industries that are found to be seriously injured by imports. The rules require prior notification and the affected countries are allowed to be compensated or can retaliate in response. The restrictions are to be applied in a nondiscriminatory fashion against the supplying countries, in line with GATT Article I, which calls for most-favored-nation treatment of member countries. One recent example was Washington's 1983 imposition of quotas and higher tariffs on specialty steel under Section 201 of the Trade Act of 1974. The European Community retaliated by restricting imports of sports equipment and some chemical products from this country.

Gradually, however, Article XIX has fallen into disuse as countries have increasingly relied on bilateral measures, such as voluntary restraint agreements and orderly marketing agreements, to protect domestic industries. The EC, for example, has negotiated 15 bilateral agreements restricting steel

imports since 1978; the United States has signed 18 such agreements since 1984. A significant number of these measures restrict imports from Japan and newly industrialized countries in Asia (see Table 4). The increased use of these "grey area" measures is a major cause of the decline in GATT's prestige and effectiveness.

Table 4: Value of Manufactured Exports to OECD Countries Subject to Trade Restrictions

(in billions of dollars)

Country of Origin	Total Manufactured Exports 1980	Subject to Restrictions* In 1980	In 1983
Japan	$61.7	$ 7.0	$21.8
Korea	10.1	2.3	3.2
Taiwan	12.0	2.0	2.2
Hong Kong	11.8	3.4	4.2
Singapore	3.6	0.2	0.3
Total	99.2	14.9	31.7

*Product items subject to restrictions are:

Japan - 1980: steel; television receivers to United States; ships.
1983: steel; one-third of television receivers to European Community; ships; automobiles; motorcycles to United States.

Korea - 1980: one-half clothing and textiles; one-third footwear; television receivers to United States.
1983: two-thirds clothing and textiles; one-third footwear to European Community; one-half steel.

Taiwan - 1980: same as for Korea.
1983: same as for Korea.

Hong Kong - 1980: two-thirds clothing and textiles.
1983: four-fifths clothing and textiles.

Singapore - 1980: one-third clothing and textiles.
1983: two-thirds clothing and textiles.

Source: OECD Observer, May 1985, p. 18.

There are two basic causes for the virtual breakdown of the safeguard system. First, the stringent requirements involved in using the GATT system make it a less attractive approach. Using grey area measures, a country has no obligation to prove that imports have caused serious injury, can single out countries for restraints and is not required to pay compensation. Second, trade actions consistent with the GATT are insufficient in dealing with the difficulties faced by declining industries, such as falling demand or a shift in comparative advantage to other producers.

Although grey area measures may be no more severe than safeguard actions, they are potentially more troublesome for several reasons. Bilateral restraints generally penalize the most efficient producer and new market entrants, often developing countries. Furthermore, these restraints are easier to initiate and maintain since the affected countries do not challenge the agreements under the GATT. It is important, therefore, that GATT principles be applied to temporary import restraints to provide fairness and discipline.

Several countries, including the United States and Japan, have called for the negotiation of a safeguards code to reverse the current trend. The unsuccessful attempt to negotiate such a code during the Tokyo Round has been referred to as that round's single largest failure. Although the 1982 ministerial meeting agreed on the general principles for a safeguards code, negotiations remain stalemated.

A successful safeguards code would require members to sacrifice some of their economic sovereignty by allowing the GATT more control over politically sensitive issues. A code should include both incentives and sanctions to persuade countries to adhere to GATT principles in taking future safeguard actions. It would be useful if the GATT secretariat were given a role in designing and monitoring import restraint programs, similar to the IMF's role in debt negotiations. Statistical standards should be established to determine when serious injury that justifies restraints has occurred. Import restrictions should decline over time and a strict time limit should apply. Since the injured industry has generally lost international competitiveness, the restraint program should foster contraction rather than revival. Moreover, it should not commit public funds to the industry or mandate private investment in that field.

Tariffs rather than quantitative restrictions should be used in safeguard actions. Domestic producers prefer the greater certainty of quotas, which better insulate them from market forces. But tariffs have the advantages of allowing imports to come from the cheapest source as well as providing revenue that can be used for worker assistance programs. Moreover, quotas establish incentives for their perpetuation, both for domestic producers and foreign exporters that hold the quota rights. The Organization for Economic Cooperation and Development reported, for example, that U.S. restrictions on Japanese steel increased Japanese profits by an estimated $200 million a year.

Controversy over whether safeguard actions may be imposed on targeted countries rather than on a nondiscriminatory basis prevented agreement on a code during the Tokyo Round. The EC argued that countries should be able to target only those nations causing the injury and not more established exporters. Developing countries, which fear that selective measures would discriminate against them, do not concur. A new safeguard code should prohibit selectivity because it lowers the cost of safeguard action and makes protection too easy.

Improvement of Dispute Settlement Procedures - A major weakness of the GATT is its inability to resolve disputes effectively. For instance, the United States complained in 1982 that the EC restricted imports of U.S. oranges and lemons. A panel did rule in favor of this country in 1985, but the EC ignored the ruling and blocked the report's adoption. Washington then abandoned GATT procedures and retaliated last November with higher tariffs on European pasta.

As this example indicates, the GATT does not have sufficient authority to impose a solution. Under the dispute settlement procedure, any member country can file a complaint alleging violation of GATT rules. A panel of experts is then established to judge the case. Since the member countries decide by consensus whether to accept the report, the alleged violater has the power to veto any recommendation -- a procedure that has been compared to having a policeman without a jail.

Further complaints hold that the GATT process is too slow, that there are too many opportunities for the "defendant" country to obstruct the process, and that decisions are often not implemented. According to an International Trade Commission survey, the process has resulted in termination of the disputed policy in only one-third of the completed cases. Some action, though, resulted in an additional 38 percent of the cases. The GATT has had some success in resolving disputes over tariffs and quotas, but it has been less effective in more complex cases involving subsidies and nontariff barriers.

The GATT's inability to enforce negotiated benefits has further contributed to disenchantment with the institution. This has encouraged countries to settle problems outside the system -- settlements that are often GATT-illegal, trade restrictive and damaging to third-country interests. Although the Tokyo Round did improve the dispute settlement procedure, and the 1982 ministerial meeting refined it further, additional steps are necessary. The establishment of a permanent panel of professional experts and strict time limits would improve the quality and speed of the process. And more fundamentally, the authority to pressure countries to implement the rulings is essential.

It is unlikely, however, that small procedural changes will substantially improve the dispute settlement process. Much of the problem reflects the difficulty of interpreting vague rules, particularly regarding agricultural commodities, and the underlying belief that trade issues are too important to be left to the GATT. Until countries develop the political will to submit to GATT discipline, the dispute settlement process will continue to be ineffective.

Extending GATT's Coverage

The GATT framework has been limited largely to manufactured goods. The new round of negotiations should bring services, agriculture and textiles into the system.

Services - The architects of the international trading system largely ignored the service sector, which includes such industries as banking, tourism, data processing, construction and engineering. Advances in telecommunications have facilitated the rapid transmission of data over long distances, enabling service industries to operate on an international scale. Although the liberalization of goods markets and capital markets has opened new international opportunities for the service sector, its exports often face import barriers more restrictive than those applied to manufactures. Moreover, constraints on foreign investment make it difficult for firms to establish the permanent facilities they need to compete successfully in local markets. Despite the lack of a coherent system of principles and procedures, global trade in services is estimated at $400-$500 billion annually, approximately 20 percent of world trade in goods and services.

Critics of the U.S. push to liberalize trade in services argue that the United States already dominates world trade in this field and would be the chief beneficiary of liberalization. Actually, trade in services is dominated by about 25 countries, which account for almost 90 percent of the total. Although the United States is the largest exporter of services (see Table 5), it is hardly dominant, accounting for only 10.8 percent of the total.

Table 5: Value of Service Exports, 1982

(in billions of dollars)

Country	Services*	Merchandise	Total	Services as Percent of Total
Argentina	$1.4	$7.6	$9.0	15.6%
Australia	3.7	20.8	24.5	15.1
Brazil	1.7	20.2	21.9	7.8
Canada	7.3	70.5	77.8	9.4
Japan	20.4	137.7	158.1	12.9
Korea	6.3	20.9	27.2	23.2
United Kingdom	28.5	97.0	125.5	22.7
United States	38.4	211.0	249.4	15.4
West Germany	29.3	171.9	201.2	14.6

*Excluding investment income and government services.

Source: General Accounting Office, Current Issues In U.S. Participation In The Multilateral Trading System, 1985, p. 41.

Some developing countries, led by Brazil and India, have insisted that the GATT applies only to trade in goods. International rules on service trade, they argue, would permit foreign interference in sovereign areas, such as banking, a key element in development policy. Those countries that have taken protective measures to foster their own information and communications sectors use the "infant industry" argument to oppose a code. They fear that powerful multinationals enjoying large economies of scale would destroy their service industries.

Key industrial countries, including Japan, are on record favoring the inclusion of services on the agenda. Given its rising share in the economies of advanced countries, service trade is too important a sector to leave out of the new round. In 1983, for example, services accounted for 57 percent of the U.S. gross national product (excluding the government sector) and employed 50.6 million workers, compared to 23.6 million in the manufacturing sector. The share of services in GNP exceeds manufacturing in other countries as well, including Japan and Great Britain. Despite its rising importance in domestic economies, service exports have been increasing more slowly than exports of merchandise -- illustrating the need for an agreement to liberalize trade. Such an agreement could benefit the developing countries by promoting an inflow of capital.

The efficiency arguments that support free trade of goods apply equally to services. The world economy loses from small-scale, inefficient service industries designed to serve single-country markets. Furthermore, liberalization of trade in services will promote free trade of goods, since services are intimately linked with trade in goods. Exports of many products depend on services, including transportation, communications, advertising, distribution and repair.

The 1982 ministerial meeting initiated a program for interested parties to gather and exchange information on service sector trade issues. The GATT secretariat became involved in these discussions in 1984. At the February 1986 meeting of the preparatory committee, however, Brazil and India remained opposed to the inclusion of services on the agenda for the new round. After negotiations begin, progress is likely to be slow given the complexity of the issues, which go beyond traditional commercial considerations and include questions of culture, privacy and national security. Domestic regulatory policies, which account for many of the nontariff barriers to service sector trade, are difficult to quantify and remove. Furthermore, government monopolies dominate many service industries.

Given the strong opposition of some developing countries, it is unlikely that an agreement based on the MFN principle can be reached. Instead, an agreement that all GATT members are free to join, such as the subsidies code, is the most likely result. Since negotiations are likely to last for some time, an important first step is to take action to prevent the introduction of new barriers. Talks begun in 1984 to include services in the government procurement code may also be useful.

Some observers argue that since each service industry is different, a sector-wide agreement is impractical and that a series of codes is preferable. But any code that is negotiated should be based on the principles of transparency and national treatment. Transparency requires open and unambiguous trade regulations -- a critical requirement since many service barriers are in the form of domestic regulations. The most contentious issue in national treatment will be whether it includes the right to establish local affiliates. Since many service industries, such as banking, require foreign investment, this would extend GATT coverage to investment. Lastly, an agreement should include effective dispute settlement and enforcement procedures.

Agriculture - Agricultural products accounted for about 15 percent of world trade in the early 1980s. But since 1955, when the United States obtained a waiver of GATT obligations to allow it to continue its domestic farm programs, agriculture has generally been outside the process of trade liberalization. Most countries pursue farm programs that are inconsistent with liberalized trade in order to achieve other goals, such as food security and income maintenance for farmers.

The rules that do exist are littered with loopholes. For example, the subsidy code permits export subsidies for primary products as long as they are not used to acquire more than a "fair and equitable share of the market." This provision has led to numerous disputes over what qualifies as a primary product and what constitutes a fair and equitable share. The dispute settlement process has struggled, often unsuccessfully, with agricultural issues, which account for more than 60 percent of GATT cases involving a specific product.

While the major disputes in farm trade involve export subsidies and quantitative restrictions on imports, the fundamental problem concerns domestic farm policies. In general, developing countries adopt policies that favor other sectors of the economy at the expense of agriculture, while developed countries do the opposite. In many advanced countries, price supports for farm goods raise prices far above world levels, thereby requiring import quotas to protect domestic markets. This naturally leads to overproduction, which in turn encourages export subsidies to get rid of surpluses. In particular, the EC's Common Agricultural Policy is under attack from all sides for increasing Europe's market share through subsidized exports. In 1984 the EC displaced the United States as the world's largest grain exporter. At the same time, though, U.S. import controls under Section 22 of the Agricultural Adjustment Act of 1933 raise sugar prices to five times world levels, while Japanese policies keep the price of rice four times world levels.

Agricultural trade was largely ignored in previous rounds. But friction over export subsidies led to the establishment of the Committee on Trade in Agriculture in 1982 to establish an agenda for multilateral negotiations. It is important to make some progress in this area, both for its own sake and to prevent animosity over agricultural disputes from spilling over into other areas, as occurred during the Kennedy and Tokyo Rounds. Last week, following the U.S. threat to retaliate against EC restrictions on imports of farm products, Sir Roy Denham of the EC warned that the disagreement threatens the start of a new round.

Several factors make the inclusion of agriculture in the new round more likely. First, there is increasing pressure from major exporters such as Australia, which has indicated that it may boycott negotiations if farm trade is not included. Second, budget constraints are likely to force reductions in domestic farm programs, allowing countries to claim credit for a trade concession. The EC faces a budget crisis this year due to spiraling farm costs, which account for three-fourths of its expenditures. West German Finance Minister Gerhard Stoltenberg told the EC that no new funds would be available until it brought the cost of farm programs under control. Budget constraints may also force a reduction in the United States, which spent an average of $19 billion a year from 1981 to 1983 on farm programs, nearly matching farm income of $23 billion. And in Japan, expenditures on "food control" are scheduled to fall 14.3 percent in fiscal 1986.

It is vital that the new round negotiate a limit on export subsidies, which have led to the dumping of farm products. Although the EC has rejected a U.S. proposal for a prohibition of such subsidies, some compromise should be possible. An agreement to phase out quotas on agricultural trade and improve the transparency of the system are also desirable.

But it will be impossible to bring agriculture fully into the GATT framework as long as countries continue their current farm programs. Agricultural policies illustrate the impact of domestic policies on international trade. Ideally, countries should follow market-oriented policies to reduce excess output and support farm income without providing incentives for overproduction.

Textiles and Apparel - Trade in textiles and apparel is largely exempt from GATT rules. Quantitative restrictions have been imposed on cotton

textiles since 1961. The Multi-Fiber Arrangement, first negotiated in 1974, now serves as the framework for bilateral restraint agreements among 17 industrial nations and 34 developing countries, and covers 3,000 products made from cotton, wool and man-made fibers. Although developed countries generally do not apply quotas against each other, the MFA is a costly policy: one study estimates that it raises clothing prices in Great Britain by 20 to 50 percent.

Negotiations to replace the current MFA, which expires in July, began in earnest last week. The developing countries have called for freer trade in textiles, although some smaller producers enjoy the security of quotas under the MFA. President Reagan, though, in vetoing the protectionist Jenkins bill to limit textile imports in December 1985, promised to "aggressively renegotiate" the MFA to protect domestic producers.

The textile talks have important implications for the success of the new round. Many developing countries will have little interest in negotiations if there is no movement toward freer textile trade. While an immediate return to free trade would lower costs, it is politically infeasible and would entail a severe dislocation after so many years of protection. A more viable solution is to return textiles to GATT rules through a gradual phaseout of the MFA during the next 10 years.

A compromise on textiles may help bring developing countries into the mainstream of GATT. They account for an increasing share of world trade as indicated by the fact that Taiwan and Korea have moved ahead of traditional exporters Switzerland and Sweden. Developing countries are presently accorded "special and differential" treatment under Part IV of the GATT through preferences and easier access to exemptions, and are not required to make reciprocal concessions in negotiations. Consequently, import barriers are much higher in most developing countries.

Actually, this special treatment is of limited value to Third World nations, while GATT has neglected many important issues of concern to them. Because the developing countries were not required in past negotiations to give reciprocal concessions to advanced countries, they got little in return. For instance, tariff escalation (see Table 6) limits the development of processing industries in raw material supplying (mainly less developed) countries, and encourages them to remain "hewers of wood and drawers of water." If developing countries become more fully integrated into the GATT framework, they will have more weight in improving the trading system in the new round.

Although the developing world is critical of the Tokyo Round results, the industrialized countries should draw them into the trade talks by offering to negotiate a safeguards code, work out effective rules for agricultural trade, liberalize trade in textiles and lower tariffs on processed goods. In turn, the developing countries should agree to negotiate a code on trade in services and reduce barriers to trade and investment. Although these are termed "concessions," they will actually promote faster economic growth. The more advanced developing countries will also have to consider "graduation" so that preferential treatment can be focused on poorer countries. Last week, the United States withdrew duty-free privileges on $2.8 billion worth of products from Taiwan, Hong Kong, Korea, Singapore and Mexico.

Table 6: Average Tariff Rates In Major OECD Countries

	United States	Japan	Canada	European Community
Finished Manufactures	6.9%	6.4%	8.1%	7.0%
Semifinished Manufactures	6.1	6.3	6.6	6.2
Raw Materials	1.8	1.4	2.6	1.6

Source: G.C. Hufbauer and J.J. Schott, Trading For Growth: The Next Round of Trade Negotiations (Washington, D.C.: Institute for International Economics, 1985), p. 77.Conclusion

Conclusion

It is essential that trading countries make progress in reversing current protectionist trends. One weakness, however, of the GATT tradition of operating by consensus is that a relatively small number of countries can stall the negotiations. If this occurs, countries that favor trade liberalization may be forced to adopt alternative strategies, such as the free trade area (FTA) negotiated between the United States and Israel in 1985.

There are several advantages to FTA negotiations. First, it tends to reverse the usual incentives in international trade talks by making countries eager to be the first to agree to liberalized trade rather than the last. Previously, countries hoarded trade barriers as bargaining chips to use in lowering other countries' barriers. With a FTA, though, each side has a reason to be the first to join in order to gain an advantage over outsiders. In addition, the incentives for outsiders to join increases as the FTA grows and trade diversion increases. Second, FTA negotiations allow countries to use free trade rather than protectionism as a lever on countries reluctant to make trade concessions. Threats of protectionism are often not credible since the country imposing the restrictions is frequently hurt as much as, or more than, the foreign country.

Many observers criticize possible FTA initiatives as a regression to the narrow, bilateral trade negotiations that characterized the 1930s. The EC's Roy Denham, for example, termed this approach a "step backwards that would fragment nations into a number of clubs." This need not be the case, however. There are GATT criteria for permissible FTAs and plurilateral agreements, such as the EC. Moreover, there is nothing intrinsically bilateral about an FTA. An FTA would be as multilateral as the number of countries that joined the agreement. Finally, regional FTAs could be the building blocks of multilateral trade liberalization in the long run.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.